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UK Votes to Leave the European Union: What Does it Mean for Fund Managers?

Following the so-called “Brexit” referendum held on 23 June 2016, the UK has narrowly voted to leave the European Union (EU). This note briefly discusses the consequences of the vote to leave, with a particular focus on fund managers—whether those managers are based within or outside of the EU.

Introduction

Following a heated campaign over the past several months, during which support for each side of the argument (remain in, or leave, the EU) oscillated, the UK electorate has voted to leave the EU. The Prime Minister, David Cameron, has resigned – although he will stay in office temporarily while a successor is chosen.

But, to be clear: this does not mean that the UK suddenly is not part of the EU or that EU rules no longer apply. The UK is still a member of the EU, and will remain so for a period of time. European-derived legislation such as the AIFMD¹, UCITS² and MiFID³ still apply in the UK, as implemented. While the markets have already reacted to the decision in a dramatic way, from a legal and regulatory perspective nothing immediately changes for fund managers.

When Will Things Change?

The UK will remain a member of the EU at least until the earlier of (i) two years following the UK’s activation of the ‘Article 50 exit procedure’⁴ (subject to any unanimously agreed extension); or (ii) the date a negotiated exit is agreed. It is generally expected that a negotiated exit will take time to conclude, since trade relationships may need to be renegotiated, and changes to the UK legal framework will be needed. In theory, it is even possible that, despite the results of yesterday’s vote, the UK will not leave the EU at all (e.g., because a further ‘deal’ is negotiated in relation to the UK’s continued membership of the EU, and another UK referendum is held).

In principle, then, the UK could remain a member of the EU for a number of years to come, while the terms of its exit are negotiated and finalised. Although it is difficult to make predictions regarding those terms of exit, or the stances that the UK and the EU member states will take in negotiations, it is likely that much of the EU law which currently has effect in the UK will continue to apply at least until the UK’s formal exit from the EU.

¹ Directive 2011/61/EU.

² Directive 2009/65/EC.

³ Directive 2004/39/EC.

⁴ The exit procedure has to be formally triggered by the UK. David Cameron has suggested that this will not occur immediately. For a discussion of this, together with an analysis of the possible relationship models which the UK and the EU may adopt, please see: “Brexit: Options for and Impact of the Possible Alternatives to EU Membership,” available at: <http://www.shearman.com/en/newsinsights/publications/2016/03/possible-alternatives-to-eu-membership>.

What Happens Once the UK Exits the EU?

The answer to this question depends on the terms on which the UK leaves the EU, and those are unlikely to be known in the coming months. There is no blueprint for a Brexit, but there are a number of relationship models that could be followed. For example, the UK could follow the approach of Norway, Liechtenstein and Iceland and seek to become a European Free Trade Association State (“EFTA State”) within the European Economic Area (“EEA”)—which would retain access to the single market. Alternatively, the UK could seek to follow the Swiss approach and become an EFTA State whilst relinquishing EEA membership, while accessing the European single market in part. A more fundamental divorce would involve the UK exiting the EU and the EEA entirely, seeking to negotiate completely new bilateral trade and access agreements and (potentially) obtaining access to the single market to some extent by virtue of ‘equivalence’ determinations.

What About the AIFMD?

As noted above, since the UK is still a member of the EU until it negotiates its exit, the AIFMD is still law in the UK, and the relevant EU legislation and guidelines still apply. In the longer term, it is unlikely that all the EU-derived laws and regulations which impact upon fund managers, including the AIFMD, will be repealed in their entirety. If the UK has negotiated access to the single market—whether by virtue of becoming a member of the European Economic Area, by bilateral agreement, or by virtue of equivalence determinations or similar—it is likely that existing laws and regulations will need to be substantially retained in return for that access. However, it is possible that legislation implementing the AIFMD will be repealed at some point in the future (again, depending on the terms of the UK’s negotiated exit), but that is far from an immediate prospect.

If the UK ultimately does not retain any access to the single market, the negotiated exit may result in UK fund managers being restricted in their ability to trade freely across the EU. Instead, branches or affiliates could need to be established in EU member states in order to achieve that.

Conclusion

The UK’s vote to leave the EU is historic and the road to exit will be complex. For some fund managers, critical decisions may need to be made about their fund structures and their cross-border (whether trading or marketing) activities. But, for the time being, the UK is still a member of the EU and should be expected to be so for a number of years. Until the UK’s formal exit, existing laws and regulations will likely continue to apply. Over the coming months, managers globally would be well-advised to look closely at the UK’s negotiations with the EU. As the likely direction of those negotiations develops, fund managers—whether within or outside of the UK—should think carefully about the practical impacts upon their business and products.

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